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Supreme Court of the United States

OCTOBER TERM, 1936.

No: 260.

IN THE MATTER

of

UNITED CIGAR STORES COMPANY OF AMERICA,

Debtor,

CITY BANK FARMERS TRUST COMPANY,
Assignee of Florence H. Bugbee,

Petitioner,

against

IRVING TRUST COMPANY, as Trustee of the Estate of the above-named Debtor, *et al*,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR RESPONDENT TRUSTEE

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR RESPONDENT TRUSTEE

OPINIONS BELOW

The opinion of the Special Master appears at page 37 of the record and is not reported. The opinion of the District Court is found in the record at page 49 and is unofficially reported in CCH Bankruptcy Law Service, par. 3702. The opinion of the Circuit Court of Appeals appears on page 71 of the record and is reported in 83 Fed. (2d) 209. All were in favor of respondents.

STATUTE INVOLVED

The provisions of Section 77B (b) of the Bankruptcy Act dealing with landlords' claims are set forth in the Appendix to this brief.

OUTLINE OF CASE

This Court is asked to review the disallowance, in proceedings under Section 77B of the Bankruptcy Act, of a landlord's claim for loss of future rent after termination of the lease, the landlord having failed to contract for any surviving liability on the part of her tenant in such event. The Special Master found that, upon the disaffirmance of the lease in prior bankruptcy proceedings of the Debtor, the landlord by her own acts had ended the lease and with it all liability of the Debtor long prior to the enactment of Section 77B. On this finding, which was confirmed by the District Court, the Court below held that the landlord had no claim since

> "Sec. 77B did not create new rights to form the basis of claims but only enlarged the remedy to make some valid claims provable in proceedings under Sec. 77B which were not before provable in bankruptcy" (R. 74).

THE FACTS

The lease in question was of premises in the City of Trenton, New Jersey, between the petitioner's assignor (in this brief referred to as the landlord) and the Debtor, for a term which, at the time of the Debtor's adjudication in bankruptcy on August 29, 1932, had nearly 14 years

still to run (R. 19, 20). The Trustee in Bankruptcy found the lease burdensome and, on November 11, 1932, rejected the lease and surrendered the premises (R. 5).

Although the lease made no provision for the Debtor's remaining liable for loss of rent after re-entry upon default, the landlord re-entered immediately (R. 5), restored certain alterations which the Debtor had made (R. 41), and entered into new leases of the property to other tenants, certain of whom were formerly sub-tenants of the Debtor (R. 33-35).[1]

So matters stood until Section 77B was enacted over 18 months later, and the Debtor had filed its petition for reorganization thereunder. Then the petitioner, as assignee of the landlord, filed a claim for $86,124.37 representing the whole rent payable under the lease from the Debtor's bankruptcy until expiration, less the alleged fair rental value during the same period (R. 3-10).

QUESTIONS PRESENTED

The Court below was confronted with two questions: *first*, whether Section 77B made provable the claim of this landlord who had terminated her lease after its rejection in the prior bankruptcy proceedings of the Debtor, albeit the rejection and termination took place before the enactment of the statute, and the

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[1]The lease provided that upon default of the tenant "it shall be lawful for the said lessor, without notice, to reenter the said premises and remove all persons therefrom" (R. 26), and that "at the expiration *or other determination of this lease*" the alterations and improvements to the premises made by the tenant should "belong to and become the property of the lessor" (R. 28).

lease contained no provision for the Debtor's liability surviving such termination,

and

second, whether the Special Master and the District Court correctly interpreted the New Jersey law in holding that in taking back her property and dealing with it as she did upon the refusal of the Trustee in Bankruptcy to adopt the lease, the landlord had terminated the lease and with it all further liability on the part of the Debtor.

The errors assigned are that in deciding each of these questions against the petitioner the Court below has misconstrued both the federal and the local law. The petitioner also contends that, in taking into consideration on the second branch of the case the effect under the lease and New Jersey law of the landlord's restoration of the premises, the Court below went outside the issues raised by the pleadings or the proof.

The first issue is a narrow one. Its determination only affects landlords' claims which are

(1) against tenants with respect to whom bankruptcy proceedings were pending *prior to* the passage of Section 77B, and

(2) based on leases which, unlike the ordinary form of lease, contain no special covenants for damage or indemnity, and in which the landlord had, during the prior bankruptcy proceedings, re-entered or otherwise terminated his rights.

In other words, the decision below leaves intact the provability of all claims that may arise or exist in the future, and as to claims under leases that were rejected during a prior bankruptcy proceeding, leaves intact those of landlords

(1) who had not re-entered or otherwise terminated prior to their tenants' filing under Section 77B, or

(2) whose leases had terminated prior to the time of such filing, but who either

(i) had independent damage covenants, or

(ii) had independent indemnity covenants.

Of the 354 claims filed by landlords in these proceedings, only 23 (including this claim) were based on leases which lacked indemnity or damage covenants. Of these, some had preserved their rights by refraining from re-entry, or by re-entering in accordance with the terms of their leases or applicable state law in such a manner as not to waive their claims against the Debtor. There are still pending the claims of 7 landlords (including this claimant) who had re-entered, or otherwise terminated their leases, without taking the necessary statutory or contractual procedure to retain claims; these 7 claims aggregate about $125,000 on the statutory three-year rental basis.

The question which this Court is called upon to decide can only arise where it is necessary to give Section 77B *retroactive* operation.

SUMMARY OF ARGUMENT

I

The bulk of petitioner's brief is directed to an interpretation of the provisions in Section 77B as applicable to a rejection of a lease *subsequent to* the enactment of the statute. It is then *assumed* that, if a rejection subsequent to the statute is to have certain legal effects, a rejection in a bankruptcy proceeding prior to the enactment of the statute must now be deemed to have had the same effects, quite regardless of anything that has happened in the interim. In this case, the rejection was over a year and a half before the enactment of Section 77B and the commencement of proceedings by the Debtor thereunder, and in the interim the petitioner's assignor terminated her lease without reservation or qualification (or at least we must so assume for the purpose of this argument).

At the time of the rejection, the landlord of course had a claim against the Debtor, in the sense that the Debtor continued liable under all of the terms of the lease. But that claim was ended by the termination of the lease.

The single question in the case is whether Congress intended to, or constitutionally could, revive an extinct claim. This is of course the same as to create a claim where none exists.

So extraordinary an intention may not be imputed to Congress in the absence of compelling language to the contrary. No such language appears in this statute.

And it is well established in the administration of insolvent estates under our system that provability of a claim presupposes the existence of a legal right. The subject matter of bankruptcy is the relationship of debtors and

creditors, the equitable distribution of estates among creditors, and the relief of debtors. None of these ends calls for the creation of new claims or for the revival of dead claims. References by the petitioner to the English statute are irrelevant, as that statute is prospective in operation only and does not touch upon the question here presented.

Nor is there any evidence in the legislative history of Section 77B to the contrary

By interpreting Section 77B as not creating new claims, or taking away valid defenses to claims which had once existed but ceased to exist prior to its enactment, the Circuit Court of Appeals has avoided a grave question as to the constitutionality of the statute.

II

Incidental questions are presented (1) as to whether the courts below correctly construed the New Jersey law, in determining that the unqualified reentry, reletting and restoration of the leased premises by the landlord terminated the lease, and (2) whether the Circuit Court of Appeals committed reversible error in basing a finding (as to the landlord's action in restoring alterations) upon a statement in the report of the Special Master.

As to New Jersey law, it is assumed that this Court will be reluctant to construe the state court cases contrary to the construction unanimously put upon them by the courts below. It appears that New Jersey belongs to that minority of states in which mere reentry does not by itself constitute a surrender and termination, but it further appears that, where the landlord has made substantial alterations in the premises for the purpose of restoration, the result is to effect a surrender by operation of law. And in this case,

the lease specifically provided that alterations and/or improvements should become the property of the lessor at the expiration or other termination of this lease. By a restoration of the premises to their original condition, the landlord clearly evidenced her understanding that the relation of landlord and tenant was at an end.

The facts as to the restoration appear in the record in the Special Master's report. The petitioner had filed a claim in the prior bankruptcy proceedings for her expenses in making the restoration. And the Special Master's report, by Rule XLVII of the General Orders of Bankruptcy, is deemed presumptively correct, and will not be reversed unless the Court is fully satisfied that error has been committed. There has been no suggestion, either by exception to the Master's report, assignment of error on appeal, or in the brief to this Court, that the petitioner had not made the restoration in question, and the point is therefore without substance.

ARGUMENT

I

THE CIRCUIT COURT OF APPEALS HAS CORRECTLY INTERPRETED SECTION 77B AS NOT CREATING A CLAIM AGAINST THE DEBTOR WHERE NONE WOULD OTHERWISE HAVE EXISTED UNDER THE LEASE PROVISIONS AND THE APPLICABLE STATE LAW.

The question of federal law considered by the Circuit Court of Appeals was whether, under Section 77B(b), the landlord in this case had "a claim for damages because of injury occasioned by the rejection of the lease by the trus-

tee in the prior bankruptcy proceeding" (R. 72). The question arose in this fashion: After the rejection of the lease in 1932 the Debtor remained as lessee. *In re United Cigar Stores Co. (Reisenweber's, Inc.)*, 69 Fed. (2d) 513, 516-517 (C. C. A. 2d), cert. den. 293 U. S. 566. Thereupon the landlord elected to reenter, restore the premises and relet to other tenants, these acts together constituting termination of the lease in accordance with its terms and under the applicable New Jersey law.[2]

Thus at the time Section 77B became law in 1934, there was no obligation owing by the Debtor to the landlord, and the landlord could, therefore, have no provable claim in these proceedings unless in enacting Section 77B Congress had, by the use of the words "injury resulting from the rejection of an unexpired lease", provided a remedy in bankruptcy where no right existed in common law or in equity.

(A) There is nothing in the language, background or legislative history of the statute which discloses an intention to create substantive rights where none existed at the time of its enactment.

1. The statutory language.

Section 77B(b)(10) defines creditors to include

> "all holders of claims of whatever character against the debtor or its property, including claims under executory contracts whether or not such claims would otherwise constitute provable claims under this Act."

The term "claims" is defined in the same section as including

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[2]See discussion under Point II, *infra*, p. 22.

> "debts, securities, other than stock, liens, or other interest of whatever character".

The statute then makes specific reference to landlords' claims as follows:

> "In case an executory contract or unexpired lease of real estate shall be rejected pursuant to direction of the judge given in a proceeding instituted under this section, or shall have been rejected by a trustee or receiver in bankruptcy or receiver in equity in a proceeding pending prior to the institution of a proceeding under this section, any person injured by such rejection shall, for all purposes of this section and of the reorganization plan, its acceptance and confirmation, be deemed to be a creditor. The claim of a landlord for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall be treated as a claim ranking on a parity with debts which would be provable under section 63 (a) of this act, * * *."

The injury to which the statute refers must be legal injury, for which an action would lie against a debtor outside of reorganization proceedings under the statute. Where a word is used in a law, it must have its legal meaning. See *Ham* v. *State of Missouri*, 18 How. 126, 133; *United States* v. *Fidelity Trust Co.*, 222 U. S. 158, 160.

When the Section 77B petition was filed, the petitioner's assignor was not a sufferer from any legal "injury", as she had no legal claim whatsoever.

The petitioner must argue, therefore, that the statute was intended to eradicate past forfeitures and surrenders, to revive dead claims, and to nullify defenses thereto.

So remarkable a view would seem to require compelling language in the statute for its support. But the only language found by the petitioner is the use of the word "re-entry" in the next sentence of the statute:

> "The claim of a landlord for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall be treated as a claim ranking on a parity with defendants which would be provable under §63 (a) of this Act, but shall be limited to an amount not to exceed the rent, without acceleration, reserved by said lease for the three years next succeeding the date of *the surrender of the premises* to the landlord or the date of *re-entry* of the landlord, whichever first occurs, whether before or after the filing of the petition, plus unpaid rent accrued up to such date of surrender or re-entry * * *." (Italics ours.)

The argument from the use of this word "re-entry" is that it connotes termination, and that Congress would not have used a word of termination as a basis for measuring claims if Congress intended claims to be obliterated by termination.

There are many difficulties with the argument. *First,* Congress could hardly have used a more indirect, artificial and disingenuous method of expressing an intention so extraordinary as the revival of a dead claim. *Second,* Congress presumably did not use the word "re-entry" in its technical sense to indicate termination, because it is coupled with the phrase "surrender of the premises", which the petitioner quite properly concedes to be a word expressive of a mere physical act rather than of a legal concept. In other words, Congress was simply measuring the limita-

tion on landlords' claims in a very practical way from the date on which the physical turnover of property would be made consequent upon rejection. *Third*, the word "reentry", even if used in a technical sense, would not necessarily connote termination, as there are some states in which reentry alone does not constitute termination. This is best evidenced by the fact that petitioner's second argument in this case is that, although its assignor concededly reentered, she did not thereby terminate.

The question whether Congress did intend that "in the future rejection should have the effect of termination, will be a question of major importance that may arise to be considered in some future case under Section 77B; but it is not presented at all in this case, as here the reentry took place long prior to the enactment of Section 77B. Accordingly, the only question in this case is whether Congress intended to revive a claim concededly dead. Such an intention would be so extraordinary as to require language far more compelling than is evidenced by the tucking away in the subordinate measurement clause of the word "reentry".

2. The background of the statute.

It has long been established in the administration of insolvent estates under the American system that provability of a claim presupposes the existence of a legal right. Thus, for a landlord to establish a claim in an insolvency proceeding (whether in bankruptcy or in equity), he has always been required to prove (i) a contract right or cause of action under the substantive law of landlord and tenant and (ii) recognition of such right or cause of action in the particular type of proceedings in question.

In equity receivership proceedings, provability was recognized when the lease contained a liquidated damage clause (*William Filene's Sons Co. v. Weed*, 245 U. S. 597) and, to a limited extent, when there was an ordinary indemnity covenant (*Pennsylvania Steel Co. v. New York City Ry. Co.*, 198 Fed. 721, 759; *Western Electric Company, Inc. v. Powers Accounting Machine Company, Claim of Pren-Brook Corp.*, unreported memorandum opinion by Mack, C. J., April 14, 1922; *Rogers v. United Grape Products*, 2 Fed. Supp. 70); but not when the lease contained merely a re-entry clause without an indemnity covenant (*Gardiner v. William S. Butler & Co.*, 245 U. S. 603).

In ordinary bankruptcy proceedings (prior to the 1934 amendment of Section 63a) only claims based on leases with liquidated damage clauses prevailed (*Irving Trust Company v. J. W. Perry, Inc.*, 293 U. S. 307), ordinary indemnity covenants not sufficing to make the claims provable (*Manhattan Properties, Inc. v. Irving Trust Co.*, 291 U. S. 320; *Miller v. Irving Trust Co.*, 296 U. S. 526).

As this Court said in the case last cited (which also involved a New Jersey lease), the landlord's claim

> "must be adjudged on the basis of the covenant that in his interest was inserted in the lease".

Admittedly Section 77B removed the barrier to provability which formerly existed in the case of landlords' claims for future rent in bankruptcy proceedings (*Manhattan Properties, Inc. v. Irving Trust Co.*, 291 U. S. 320). But there is nothing to indicate that Congress intended to re-make the agreement between the parties for the purposes of the federal Bankruptcy Act, or (to use the language of

petitioner's brief, at p. 20) "that the technical law of landlord and tenant of the states should not be applied in the administration of the federal bankruptcy law" under Section 77B.

Certainly, if Section 77B was supposed "to do away for the purpose of the bankruptcy law with the historical distinction between leases and other types of obligations" (petitioner's brief, p. 42), Congress should have so declared in clear and unambiguous language (*Maynard* v. *Elliott*, 283 U. S. 273, 277).

The petitioner and the *amici curiae* say that at the time of enacting Section 77B Congress had in mind the language of the English bankruptcy acts making landlords' claims for loss of future rent provable.[3] This is an argument similar to the argument based on the use of the word "reentry" (*supra*, p. 11), in that here again the petitioner's purpose is to show that Congress intended that a rejection in the future should have the same effect as a termination. But this again is irrelevant to the question whether Congress intended to revive, or could constitutionally revive, a dead claim. Petitioners do not suggest that even the English statute attempted to revive dead claims, or otherwise to clothe a previously consummated act with legal effects different from that which it had at the time that it occurred.

When this Court is presented with the question whether a rejection of a lease has all the legal effect of a termination, it will no doubt be relevant to consider the English statute.[4]

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[3]Petitioner's brief, at page 14; *amici curiae* brief, at page 15.

[4]And it will then incidentally appear that the English statute is quite different from our statute in that it contains an *express* provision that "disclaimer" (the nearest English equivalent to our "rejection") operates to put an end to all

3. The purpose and legislative history of Section 77B.

Not merely is there no evidence on the face of the statute or in its background to support the petitioner's theory of legislative intent, but it is contrary to the expressed purpose of the sponsors of the statute.

Senator Hastings, who had charge of the bankruptcy amendments, stated that future rent claims would be provable

> "because we have undertaken in these sections to include all the claims that could be had against a debtor, so that when he got relief he might know that he had relief from every kind of a claim that might be had against him." [76 Cong. Rec. 4906]

The emphasis upon relief against actual claims, and the absence of even an implied intent to add to existing claims, is apparent.

The petitioner relies upon a change which the Senate itself made in the House bill. The bill (H. R. 5884, 73rd Cong., 1st Sess.), as it was originally passed by the House, contained a provision looking solely to the future, and substantially similar to the English provision, as follows:

> "In case any executory contract shall be rejected, the same shall be deemed to have been breached [as of the date of the approval of the petition or answer filed], and the holder shall be entitled to file a claim for damages for such breach, and such claim may

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rights and liabilities of the bankrupt as well as the trustee. 4 and 5 Geo. V (c) 59. Under our statute (prior to Section 77B), the interest in the lease following rejection remains in the bankrupt (*Watson* v. *Merrill*, C. C. A. 8th, 136 Fed. 359, 363; *In re Frazin*, C. C. A. 2d, 183 Fed. 28) and Section 77B contains no such express provision.

> be allowed provided such contract shall not have been terminated by forfeiture, re-entry or otherwise." (Matter in brackets ours.)

This provision was changed by an amendment on the floor of the Senate to a form substantially similar to that finally adopted, viz.:

> "In case any executory contract or unexpired lease of real estate shall be rejected pursuant to direction of the judge given in a proceeding instituted under this section, or shall have been rejected by a trustee in bankruptcy or receiver in equity in a proceeding pending prior to the institution of a proceeding under this section, any person injured by such rejection shall for all purposes of this section and of the reorganization plan, its acceptance and confirmation, be deemed to be a creditor to the extent of the injury resulting from such rejection. * * *" (78 Cong. Rec. 8109).

The change was essentially two-fold, (1) application to prior pending bankruptcy proceedings as well as to future proceedings, offset by (2) elimination of the explicit provision as to the effect of rejection and its replacement by the simpler formula that those who are "injured" may recover. That formula left to existing law the determination of who is "injured". But, concededly, under existing law this petitioner was not an "injured" person when the statute was enacted or when it was applied to this estate.

And the original phrasing was insufficient from the landlord's point of view in two important respects:

First, the typical lease[5] contains a covenant for damages or indemnity after termination,[6] and the reference in the original statutory phrasing to every "holder" of an executory contract might well have been construed to cover every holder of such a covenant, with the consequence that claims on the covenants themselves would have been lost by termination.

Second, the original phrasing was wholly inapplicable to pending bankruptcy or equity receivership proceedings.

Judge Learned Hand of the Circuit Court of Appeals had the following to say in the *Kuehner and Fischer* case, No. 354 here, with regard to the petitioner's argument that this change indicated an intention on the part of Congress to grant a claim for rejection to a landlord regardless of the termination of his lease (85 Fed. (2d) 35, 37):

> "At least the original bill attempted nothing of the sort, and a change of language so inartificial and obscure ought not, it seems to us, be given so extravagant an effect. It is not necessary to read it so; it is enough if the language be taken to mean that the 'rejection' of a lease shall be a present breach of all the lessee's promises, either to pay rent, to rebuild, to cover taxes or whatever else they may be. Indeed, if it continues his liability after reentry, it was redundant to include covenants 'for damages or indemnity'. We do not therefore believe that this language creates new claims after reentry, * * *."

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[5]Represented, for example, by 331 out of the 354 leases on which proofs of claims were filed in the present proceedings. See [redacted] page 5.

[6]See *Manhattan Properties, Inc.* v. *Irving Trust Co.*, 291 U. S. 320, 337 *et seq.*

There was, therefore, ample reason for the amendments introduced by the Senate, without inferring that they were made for the extraordinary purpose of reviving claims which the parties themselves had terminated or forfeited. Indeed, it seems obvious that when a brief statutory provision having only *prospective* operation is expanded and altered so as to cover *retrospective* application as well, inferences cannot be drawn from the precise phrasing of the former for the purpose of giving a distorted construction to the latter.[7]

(B) *By interpreting Section 77B as not creating new claims, or taking away valid defenses to claims which had once existed but had ceased to exist prior to its enactment, the Circuit Court of Appeals has avoided a grave question as to the constitutionality of the statute.*

It is, of course, a familiar canon of construction that

> "A statute must be construed if fairly possible, so as to avoid not only the conclusion that it is unconstitutional but also grave doubts on that score." (*Linder* v. *United States,* 268 U. S. 5, at 17-18.)

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[7]One commentator (Mr. Henry Friendly) has said of the change (48 Harv. L. R. 39, 65):

> "But the amendment also changed the bill in other respects, notably in limiting the amount of the landlord's claim, and there is nothing either in the language of the Act or in the debates that shows an intention to confer on a landlord the right to prove a claim in a case where he would never have been able to sustain an action at law."

To the same effect is the report, dated June 12, 1935, of former Judge Thomas D. Thacher, sitting as Special Master in the reorganization proceedings of Radio-Keith-Orpheum Corporation (D. C. S. D. N. Y., unreported).

Concededly, this landlord had, on the day previous to the filing of the Debtor's petition under Section 77B, no claim either against the bankrupt estate of the Debtor or against the Debtor itself. Against the estate the landlord had no claim because of the ruling in the *Manhattan Properties* case (291 U. S. 320). Against the Debtor she had none because she had previously terminated her lease.

This Court said in the *Manhattan Properties* case, 291 U. S. 320, at page 332, that under its bankruptcy power Congress may permit landlords' claims to be proven in bankruptcy proceedings or it may exclude them altogether. This seems to us, however, to mean no more than that Congress may give the character of provability to a valid claim, not that Congress can (constitutionally) create claims.

Although the courts have never attempted precisely to delimit the bankruptcy power, the decisions from the earliest days have defined it in terms of debtors and their creditors, meaning, of course, existing creditors.[8] The word "bankruptcy" itself has always referred to the relation of debtors with their creditors (*Continental Illinois National Bank and Trust Co.* v. *Chicago, R. I. & Pac. Ry. Co.*, 294 U. S. 648, 672), and thus bankruptcy legislation is primarily concerned with the adjustment of individual rights and liabilities which have their source in local law. Never, however, has the bankruptcy power been exercised to create a new class of obligations of a debtor which would not have existed otherwise.

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[8]Such cases include *In re Klein*, 1 How. 277 (C. C. Mo.); *In re Reiman*, Fed. Cas. 11,673; *Hanover National Bank* v. *Moyses*, 186 U. S. 181; *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S. 555, at 582 *et seq.*; and *Continental Illinois National Bank & Trust Co.* v. *Chicago, R. I & Pac. Ry. Co.*, 294 U. S. 648, 667-674.

Moreover, viewed conversely, if Congress has, in enacting Section 77B, created for this landlord a claim in bankruptcy, it has at the same time taken away from the Debtor a valid defense (discharge of liability through termination of the lease). With equal force it could be argued that Section 77B has taken away defenses to claims based on the statute of limitations, or the statute of frauds, or usury. Yet precisely the opposite has been held as regards the provability of claims in ordinary bankruptcy proceedings, although the language of Section 63(a) is open to the same construction. *In re Stern*, 144 Fed. 956 (C. C. A. 8th); *In re German-American Improvement Co.*, 3 Fed. (2d) 572 (C. C. A. 2d); *Remington on Bankruptcy, Fourth Edition*, §§ 1479, 1484.

The contrary would be a strange result for a statute entitled "for the *relief* of debtors". *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S. 555, at 588:

> "The discharge of the debtor has come to be an object of no less concern than the distribution of his property."

It is familiar and fundamental law that a vested defense to a claim or action is fully protected from being cut off or destroyed by subsequent legislative action, whether the defense is based upon a contract or principles of common law. *Pritchard* v. *Norton*, 106 U. S. 124, 132; *Forbes Pioneer Boat Line* v. *Board of Commissioners*, 258 U. S. 338; *P. Ballantine & Sons* v. *Macken*, 110 Atl. 910 (N. J.). This rule applies here where the defense—surrender by operation of law—"did something more than resist the remedy"; it "disproved the right of action" (*Winfree* v. *Northern Pacific Ry. Co.*, 227 U. S. 296, 302). Indeed, courts endeavor to hold inapplicable even changes in the

form of remedies, "where the effect is to reach backward and nullify by relation the things already done." (Cardozo, *J.*, in *Matter of Berkovitz* v. *Arbib & Houlberg*, 230 N. Y. 261, 270.) See also *U. S. Fidelity & Guaranty Co.* v. *Struthers-Wells Co.*, 209 U. S. 306.

Finally, there is still another serious constitutional question presented if, by the use of the words "injury resulting from rejection", Congress gave to the act of the Debtor's trustee in bankruptcy, in rejecting the petitioner's lease in 1932, a consequence it was not intended to have and did not have at the time. As this Court has held,

> "A statute having such a result may incur the opposition of the Constitution. When such may be the result a different construction of the statute is determined." (*Union Pacific R. R. Co.* v. *Laramie Stock Yards Co.*, 231 U. S. 190, 200.)

The same would be true of any statute enacted under a federal power if "construed retroactively to create liability". *William Danzer Co.* v. *Gulf, etc. R. R.*, 268 U. S. 633, 637:

> "To give it that effect would be to deprive defendant of its property without due process of law in contravention of the Fifth Amendment".

The converse of the situation here presented arose in *Auffm'ordt* v. *Rasin*, 102 U. S. 620, where this Court stated, referring to an amendment of the Bankruptcy Act changing from four to two months the period within which preferential transfers should be voidable:

> "But this statute is not a statute of limitation of actions, but a declaration of a period when an act otherwise voidable shall be held to be valid; and we

> see no reason to believe that in making a new rule on that subject Congress intended to make it retrospective, for the purpose of destroying rights of property or rights of action which had become vested before the passage of the law."

The petitioner argues that when a Debtor has voluntarily filed a petition under Section 77B, the Trustee of its estate is estopped to suggest that grave constitutional doubts be avoided in the interpretation of the statute. The argument is that a person cannot avail himself of the benefits of a statute and at the same time seek to escape its burdens. But the very point here at issue is whether the statute intends the Debtor to be subjected to the burdens for which the petitioner contends. In the three cases cited by the petitioner (brief, p. 38), direct assaults on the validity of the statutes in question were made by those who had accepted benefits under them; not so in this case. Far from asserting the unconstitutionality of Section 77B or any part of it as it stands, the respondent's sole effort is to *avoid* any question of its constitutionality being raised now or in the future by the adoption of the strained interpretation urged by the petitioner.

II

BY HER UNQUALIFIED REENTRY, RELETTING AND RESTORATION OF THE LEASED PREMISES IN NOVEMBER, 1932, THE LANDLORD TERMINATED THE LEASE AND ENDED ALL FURTHER LIABILITY OF THE DEBTOR THEREUNDER.

The petitioner does not dispute that if a surrender of the lease by operation of law did take place in November,

1932, no liability of the Debtor to the landlord for rent to accrue thereafter would have survived. New Jersey follows the common law rule in effect in most states that where, as here, the lease contains no indemnity covenant or damage clause, a surrender extinguishes all further liability of the tenant. See *Fleming* v. *Matter Const. Corp.*, 164 Atl. 585, at 586 (N. J.); and annotations in 18 A. L. R. 957, at 960, and 58 A. L. R. 906.

(A) *The landlord's acts indicated an acceptance of surrender.*

The actual conduct of the landlord in this case is not disputed, and there was presented no evidence of her intention other than that to be inferred from her acts. Immediately after the Debtor's Trustee in Bankruptcy rejected the lease and abandoned the premises in November, 1932, the landlord reentered and proceeded to make new leases with other tenants for various portions of the premises (R. 20, 33-35). Some of these new leases were with others than the former subtenants of the Debtor, and several were for long terms. No notice was given by the landlord to the Debtor (or indeed to the Trustee in Bankruptcy), either of intention to relet the premises for the benefit of the Debtor, or of the reletting itself. A final determinative indication of the landlord's understanding that she was quit of the Debtor as a tenant and that the lease was completely at an end, is her action, as found below, in restoring structural alterations that had been made to the premises by the Debtor, which under the lease she was not free to do until its "expiration or *other determination*" (R. 28).

The first intimation that the landlord chose to consider the Debtor as remaining liable for rent accruing after she

had taken back the premises, was the filing of the claim which is the subject of this appeal. This was on October 10, 1934, nearly two years after the landlord-tenant relationship had evidently come to an end.

(B) *Under New Jersey law the Debtor's liability as tenant did not survive in this case.*

Although there are several different theories as to how a landlord whose lease contains no indemnity covenant may reenter the demised premises without discharging the tenant from liability on the lease, the rule that is almost universally followed is the common-law rule that reletting by the landlord without intent to hold or to act for the account of the tenant effects a surrender. See extensive annotations in 3 A. L. R. 1080; 52 A. L. R. 154 and 61 A. L. R. 773.

In New Jersey the rule is stated as follows:

> "The essentials of this recognized mode by which the relation of landlord and tenant may be terminated were stated by Mr. Justice Collins in the case of *Mecker* v. *Spalsbury,* 37 Vroom 60, and the statement there made was approved and adopted by this court in the more recent case of *Miller* v. *Dennis,* 39 *Id.* 320. The text is: 'When the minds of the parties to a lease concur in the common intent of relinquishing the relation of landlord and tenant and execute this intent by acts which are tantamount to a stipulation to put an end thereto, there at once arises a surrender by act and operation of law.'" (*Syphcrd* v. *Myers,* 80 N. J. L. 321, 324.)

The same case further clarifies the rule:

> "That the giving up of possession to the landlord, if acted upon by him, is such an act is the established rule tersely stated by Mr. Justice Tindal

> in *Dodd* v. *Acklom*, 6 M. & G. 672: 'A change of possession by the consent of both parties amounts to a surrender by operation of law.' "[9]

It is apparent that in New Jersey an unqualified resumption of possession and a reletting by a landlord, especially when accompanied by alterations in the premises, as in the present case, constitute a surrender. *Sypherd* v. *Myers, supra; Fink* v. *Browe Co.* (N. J. C. H.), 99 Atl. 926; *Miller* v. *Dennis*, 53 Atl. 394, cited in *In re Sherwoods*, 210 F. 754, 759.

Indeed, the holding in *Fink* v. *Browe Co., supra*, is based on a set of facts practically identical with those here. The lessee's receiver rejected the lease and returned the keys to the landlord, who received them without objection and then altered and rerented the premises without consulting the receiver or the lessee. The court refused to allow the landlord's claim for rent accruing after the reentry, on the ground that the lease had been terminated by a surrender. In this respect it stated (at p. 927):

> "There has been no surrender in writing of the term as required by the statute of frauds (2 C. S. 1910, p. 2610, § 2), and if the surrender is found to have taken place, it must have arisen by act and operation of law, and the conduct of the landlord in accepting the keys without objection, and in entering upon the premises without consulting the receiver, and making changes and alterations therein that were not necessary as repairs for the preserva-

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[9] In the recent case of *Clark* v. *Byrne*, 187 Atl. 165, 167, the New Jersey Court of Errors and Appeals said of its earlier decision:

> "The doctrine of surrender by operation of law is amply reviewed and stated in *Sypherd* v. *Myers* * * *".

> tion of the building, and in advertising the premises for rent, and in renting the greater part of them for less than the balance of the demised term and for less than the annual rent fixed by the lease, without authority from the receiver and without consulting him, indicate an intention on the part of the landlord to accept the receiver's abandonment as a surrender and to hold possession of the premises on his own account."

The court also stressed the fact that there was no provision in the lease giving the landlord a right to reenter and relet for the tenant's account.

(C) *The petitioner's authorities are not applicable to the facts here.*

The petitioner criticizes the Circuit Court of Appeals' holding that in the present case the reentry, reletting and substantial changes in the premises made by the landlord *taken together* show that the landlord must be held to have accepted a surrender. The petitioner's position is that even if accompanied by reletting, *repairs* made by a landlord for the purpose of preserving the premises from injury do not *per se* effect a surrender of the lease. But the cases cited for this proposition have no bearing upon the situation at bar where the changes made were in the nature of *alterations.*

In *Meeker* v. *Spalsbury,* 66 N. J. L. 60, the lease provided that the landlord might enter *at any time* in order to make repairs necessary for the preservation of the premises, and also that the landlord might relet for the account of the tenant. Upon abandonment by the tenant the landlord made alterations, and, since the lease gave the landlord a

right to repair and not to alter, it was held that the making of alterations was inconsistent with a continuance of the landlord-tenant relation and that a surrender occurred. In the instant case there was no provision for reletting on the part of the landlord, who likewise breached a provision of the lease in making alterations before the normal expiration or other determination of the lease.

In *Banks v. Berliner,* 95 N. J. L. 267, upon abandonment by the tenant the landlord went no further than in making certain necessary repairs to the plumbing, and no question of restoring alterations arose. In *Block* v. *Bell,* 111 N. J. Eq. 551, the lease contained an express provision that if a receiver was appointed the tenant would immediately restore the premises to their condition at the commencement of the term. Consequently, on appointment of a receiver for the tenant and failure to restore, the landlord recovered a claim for the cost of the "substantial structural changes" necessary to restore the premises. In *Liskovsky* v. *Blau,* 176 Atl. 562, the record on appeal reveals that the lease expressly authorized the landlord to reenter and relet the premises as agent of the tenant and to hold the tenant liable for any deficiency (State of Case, p. 43). There was no clause, as here, in respect of alterations and improvements, and the nature of the repairs made is not disclosed, the opinion merely stating that the "proofs showed that the repairs were made for the purpose of preserving the buildings * * *" (176 Atl. at 563).

Thus, the *Liskovsky* and *Banks* cases had merely to do with necessary and apparently minor *repairs,* not *alterations,* and the *Meeker* and *Block* cases turn on the operation of express lease provisions with regard to alterations. None of the cases support a conclusion that alterations made

by a landlord, in addition to a reletting not authorized by the lease, do not effect a surrender.

The petitioner also cites *Zabriskie* v. *Sullivan,* 80 N. J. L. 673, aff'd 82 N. J. L. 545, for the proposition that repairs equivalent to restoration, even when accompanied by reletting, do not effect a surrender. The landlord in that case acquiesced in his tenant's abandonment only under protest, expressly notifying the tenant to that effect and stating that he reentered solely for the purpose of reletting for the account of the tenant. The landlord then made certain repairs which normally it would have been the duty of the tenant to make. Further, there is nothing in the case to indicate that such repairs amounted to restoration of alterations.

It is the Trustee's contention that in New Jersey, as in other jurisdictions, reentry, reletting and substantial changes in the premises for the purpose of restoration by the landlord, taken together, effect a surrender by operation of law where, as here, the lease did not empower the landlord to relet for the tenant's benefit. But the facts of the present case go even further. The lease provides that the lessor consents to the making of "alterations and/or improvements" by the lessee, "said improvements to belong to and become the property of the lessor *at the expiration or other determination of this lease*" (R. 28). Thus, by wiping out the changes made by the Debtor and restoring the premises to their original condition, the landlord clearly evidenced her understanding that the relation of landlord and tenant was at an end. See *Meeker* v. *Spalsbury, supra.*[10]

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[10]The petitioner objects to this conclusion on the ground that only improvements and not alterations were to become the property of the landlord when the lease determined. It

III

IT WAS NOT REVERSIBLE ERROR FOR THE SPECIAL MASTER TO INCLUDE IN HIS REPORT A FINDING THAT THE LANDLORD HAD RESTORED ALTERATIONS MADE TO THE LEASED PREMISES BY THE DEBTOR.

The District Court held, and was affirmed by the Circuit Court of Appeals, following the Special Master, that "the reentry of the landlord under the lease and her *subsequent* acts terminated all liability on the part of the tenant" (R. 50). The "subsequent acts" were (a) the restoration of the alterations made by the Debtor, which under the lease the landlord was only free to do at its "expiration or other determination" (R. 28), and (b) the reletting to other tenants without notice to the Debtor. The petitioner's grievance is that of these three acts (*i.e.*, the reentry, the restoration and the reletting) only the first and third were referred to in the stipulation of facts entered into by the parties, the facts with regard to the restoration being judicially noticed by the Special Master when he came to prepare his report to the District Court.

This was not made the subject of an exception to the Special Master's report (R. 43-45), nor was it assigned as error to the Circuit Court of Appeals (R. 58-61).

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seems hardly necessary to say that a provision that alterations as well as improvements were to become the landlord's property would have been surplusage. Improvements such as a shop window might conceivably be removed by the tenant, but ordinarily it would not be necessary to provide against the removal by the tenant of an *alteration* to the premises.

There had previously been filed with the Special Master (then sitting as Referee in Bankruptcy) a proof of claim on behalf of this same landlord for expenditures incurred in making the restorations in question. That proof of claim expressly stated that "the lease is now *expired* by reason of the bankruptcy." Since that proof of claim was by a general order of the District Court pursuant to Section 77B(c)(6), made part of the Court records in these proceedings, the Special Master very properly took notice of the allegations made by the landlord therein.

While not denying that the restoration actually took place nor challenging the Special Master's right to take notice thereof, the petitioner contends that it was improper for such facts to be taken into consideration by the Court below in reaching its decision. The only ground for the petitioner's complaint seems to be that in objecting to its claim on the ground that there had been a surrender of the lease, thereby terminating all future obligations of the Debtor thereunder, the Trustee only made specific reference to two of the three evidentiary facts that were the basis of the Special Master's decision, that is, to the reentry and the reletting but not to the restoration (R. 14).

The Circuit Court of Appeals was not impressed with this rather technical objection and declined to send the case back in order for the Trustee to plead a fact as to which there was no dispute. We submit that this did not constitute reversible error or grounds for the granting of a writ by this Court, particularly in the light of Rule XLVII of the General Orders in Bankruptcy promulgated by this Court which directs that the reports of special masters in proceedings under Section 77B "shall be deemed presumptively correct" and provides for the modification or rejection

of such reports only when the court is *"fully satisfied* that error has been committed".

Neither of the cases cited by the petitioner in this connection is in point. In *General Utilities Co.* v. *Helvering,* 296 U. S. 200, the Commissioner of Internal Revenue had raised a question of fact before the Circuit Court of Appeals that had not been presented to or ruled on by the Board of Tax Appeals, although the Court was without power in such a case to make any findings of fact. But in the present case the landlord's conduct in making the restoration was specifically included in the findings of fact of the Special Master, on the basis of which the Court below rendered its decision. Moreover, the petitioner, in its exceptions to the Special Master's report, did not assign as error the inclusion in the report of the facts as to the restoration.

In *Liberty National Bank* v. *Bear,* 265 U. S. 365, the case was remanded because the trustee in bankruptcy, in seeking to invalidate a lien under Section 67f of the Bankruptcy Act, had failed to allege or prove that the debtor was insolvent when the lien was obtained. There is nothing, however, to indicate that this Court would have reached the same conclusion had the Debtor's insolvency been shown by the record (even though not pleaded by the trustee), as is the case here with respect to the restoration of the alterations.

CONCLUSION

We respectfully submit that the judgment of the Circuit Court of Appeals should be affirmed.

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APPENDIX

Statute Involved

"The term 'creditors' shall include for all purposes of this section and of the reorganization plan, its acceptance and confirmation, all holders of claims of whatever character against the debtor or its property, including claims under executory contracts, whether or not such claims would otherwise constitute provable claims under this Act. The term 'claims' includes debts, securities, other than stock, liens, or other interests of whatever character. For all purposes of this section unsecured claims which would have been entitled to priority over existing mortgages if a receiver in equity of the property of the debtor had been appointed by a Federal court on the day of the approval of the petition or answer under this section, shall be entitled to such priority, and the holders of such claims, and of other claims, if any, of equal rank, shall be treated as a separate class of creditors. In case an executory contract or unexpired lease of real estate shall be rejected pursuant to direction of the judge given in a proceeding instituted under this section, or shall have been rejected by a trustee or receiver in bankruptcy or receiver in equity, in a proceeding pending prior to the institution of a proceeding under this section any person injured by such rejection shall, for all purposes of this section and of the reorganization plan, its acceptance and confirmation, be deemed to be a creditor. The claim of a landlord for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall be treated as a claim ranking on a parity with debts which

would be provable under section 63 (a) of this Act, but shall be limited to an amount not to exceed the rent, without acceleration, reserved by said lease for the three years next succeeding the date of surrender of the premises to the landlord or the date of reentry of the landlord, whichever first occurs, whether before or after the filing of the petition, plus unpaid rent accrued up to such date of surrender or reentry: * * *." (Bankruptcy Act of July 1, 1898, as amended, Section 77B (b) (10); 11 U. S. C. A. Sec. 207 (b) (10).)